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Message Text

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TO ALL DIPLOMATIC AND CONSULAR POSTS

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INFORM CONSULS

E.O. 11652:N/A

TAGS: EFIN, US

SUBJECT: ADMINISTRATION'S PROPOSALS ON TAXATION OF U.S.
BUSINESSMEN WORKING ABROAD
AT WAYS AND MEANS COMMITTEE HEARINGS FEBRUARY 23,
ADMINISTRATION PROPOSED SEVERAL CHANGES TO RULES ON
TAXATION OF AMERICANS WORKING OUTSIDE THE UNITED STATES.
WE BELIEVE THESE PROPOSALS PROVIDE FAIR AND WORKABLE RULES
WHICH TAKE INTO ACCOUNT DIFFERING CIRCUMSTANCES ENCOUN-
TERED BY U.S. CITIZENS AND RESIDENT ALIENS WORKING ABROAD.
ADMINISTRATION FURTHER RECOMMENDED THAT IMPLEMENTATION OF
1976 AMENDMENTS AFFECTING BUSINESSMEN ABROAD BE DELAYED
AND THAT THE NEW PROPOSALS BE SUBSTITUTED. BELOW IS A
DETAILED SUMMARY OF THE ADMINISTRATION'S PROPOSALS.

2. PRESENT LAW
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UNITED STATES CITIZENS ARE GENERALLY TAXED BY THE
UNITED STATES ON WORLDWIDE INCOME AND ARE ENTITLED TO A
TAX CREDIT FOR FOREIGN TAXES PAID. HOWEVER, THERE ARE
CERTAIN EXCEPTIONS TO THIS GENERAL RULE FOR CITIZENS
LIVING AND WORKING OUTSIDE THE UNITED STATES.

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UNDER SECTION 911 OF THE INTERNAL REVENUE CODE, AS AMENDED BY THE TAX REFORM ACT OF 1976, UNITED STATES

CITIZENS WHO REMAIN IN A FOREIGN COUNTRY FOR 17 MONTHS IN ANY CONSECUTIVE 18 MONTH PERIOD OR WHO ARE BONA FIDE RESIDENTS OF A FOREIGN COUNTRY AND HAVE BEEN FOR AT LEAST ONE FULL TAXABLE YEAR MAY EXCLUDE UP TO $15,000 OF EARNED INCOME. THE EXCLUDED AMOUNT IS $20,000 FOR EMPLOYEES OF UNITED STATES ORGANIZATIONS THAT QUALIFY AS TAX EXEMPT ORGANIZATIONS. NO DEDUCTIONS OR CREDITS CHARGEABLE AGAINST INCOME EXCLUDED UNDER SECTION 911 MAY BE TAKEN AGAINST OTHER INCOME. IN ADDITION, THE EXCLUSION APPLIES TO THE LOWEST BRACKET INCOME; ADDITIONAL INCOME IS SUBJECT TO UNITED STATES TAX AT THE RATES THAT WOULD APPLY IF THERE WERE NO SECTION 911 EXCLUSION.

PRIOR TO ITS AMENDMENT BY THE TAX REFORM ACT OF 1976, SECTION 911 PROVIDED THAT UNITED STATES CITIZENS WORKING ABROAD COULD EXCLUDE UP TO $20,000 OF EARNED INCOME ($25,000 IF THEY WERE BONA FIDE RESIDENTS OF A FOREIGN COUNTRY FOR MORE THAN 3 YEARS). THE EXCLUSION APPLIED TO THE HIGHEST BRACKET EARNINGS. CITIZENS COULD CLAIM CREDIT FOR FOREIGN TAXES ATTRIBUTABLE TO EXCLUDED EARNINGS, BUT SUCH EARNINGS REDUCED THE FOREIGN TAX CREDIT LIMITATION UNDER SECTION 904.

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3. EXPLANATION OF PROPOSAL

THE ADMINISTRATION'S PROPOSAL WILL REPLACE THE EXISTING SECTION 911 OF THE CODE WITH A NEW SECTION 221 THAT PROVIDES FOR SPECIAL DEDUCTIONS FOR UNITED STATES CITIZENS AND RESIDENT ALIENS WORKING ABROAD.

THE ADMINISTRATION'S PROPOSAL WILL ALSO BROADEN THE CONDITIONS UNDER WHICH MEALS AND HOUSING FURNISHED BY THE EMPLOYER ARE EXCLUDABLE FROM INCOME UNDER SECTION 119. IN ADDITION, SECTION 217 WILL BE AMENDED TO PROVIDE INCREASED TIME LIMITS AND A HIGHER CEILING FOR DEDUCTIONS FOR INTERNATIONAL MOVES. SECTION 1034 WILL ALSO BE AMENDED TO PROVIDE ADDITIONAL TIME FOR PERSONS QUALIFYING FOR SECTIONS 911 OR 912 TO REINVEST THE PROCEEDS FROM THE SALE OF A PRINCIPAL RESIDENCE WITHOUT HAVING TO RECOGNIZE GAIN.

4. A DETAILED EXPLANATION OF THE MAJOR PROVISIONS OF THE ADMINISTRATION'S PROPOSALS IS SET FORTH BELOW.

CHANGES TO SECTION 911

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THE ADMINISTRATION'S PROPOSAL WILL REPLACE SECTION
911 OF THE CODE WITH A NEW SECTION 221 THAT WILL GIVE
UNITED STATES CITIZENS AND RESIDENT ALIENS WHO ARE

BONA FIDE RESIDENTS OF FOREIGN COUNTRIES FOR AN ENTIRE
TAXABLE YEAR OR WHO ARE PHYSICALLY PRESENT IN FOREIGN
COUNTRIES FOR 334 DAYS DURING THE TAXABLE YEAR A DEDUCTION
FOR CERTAIN EXPENSES INCURRED FOR HOUSING, EDUCATION AND
HOME-LEAVE TRAVEL. THE AMOUNT DEDUCTIBLE UNDER THE NEW
SECTION WILL, HOWEVER, BE LIMITED TO THE AMOUNT OF EARNED
INCOME FROM FOREIGN SOURCES. FOREIGN TAXES ATTRIBUTABLE
TO AMOUNTS DEDUCTED WILL NOT BE DISALLOWED, ALTHOUGH THE
DEDUCTIONS WILL BE ATTRIBUTABLE TO FOREIGN SOURCE INCOME
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AND THUS WILL REDUCE THE SECTION 904 LIMITATION ON THE
CREDIT.
HOUSING: A DEDUCTION WILL BE ALLOWED FOR THE EXCESS
OF THE ACTUAL AMOUNT INCURRED FOR REASONABLE HOUSING (RENT
AND UTILITIES) OVER 20 PERCENT OF EARNED INCOME NET OF
ACTUAL HOUSING COSTS AND THE ALLOWABLE DEDUCTIONS FOR
EDUCATION AND HOME-LEAVE TRAVEL. THIS 20 PERCENT FIGURE
IS BASED ON THE PREMISE THAT A TYPICAL AMERICAN LIVING
OVERSEAS WOULD SPEND APPROXIMATELY 1/6 OF HIS INCOME ON
HOUSING IF HE LIVED IN THE UNITED STATES; 20 PERCENT OF
$20,000 OF EARNED INCOME NET OF HOUSING AND THE OTHER
SPECIAL DEDUCTIONS EQUALS $4,000, 1/6 OF $24,000. IN THE
CASE OF HOUSING FURNISHED BY THE EMPLOYER, THE EMPLOYEE
WILL INCLUDE IN INCOME THE FULL FAIR MARKET VALUE OF THE
HOUSING (INCLUDING UTILITIES), BUT WILL BE ALLOWED TO
DEDUCT THE EXCESS OF THE FAIR MARKET RENTAL VALUE OVER 20
PERCENT OF EARNED INCOME NET OF HOUSING AND THE ALLOWABLE
DEDUCTIONS FOR EDUCATION AND HOME-LEAVE TRAVEL. THE
DEDUCTION FOR HOUSING FURNISHED BY THE EMPLOYER WILL NOT
BE AVAILABLE TO TAXPAYERS CLAIMING AN EXCLUSION FOR
EMPLOYER-FURNISHED HOUSING UNDER SECTION 119.

EDUCATION: A DEDUCTION WILL BE ALLOWED FOR TUITION,
BOOKS AND ROOM AND BOARD UP TO $4,000 PER YEAR FOR EACH
DEPENDENT CHILD IN GRADES 1 THROUGH 12, PLUS ACTUAL
ECONOMY TRAVEL FOR TWO ROUND TRIPS PER YEAR BETWEEN THE
SCHOOL AND THE FOREIGN RESIDENCE. THE TRANSPORTATION
DEDUCTION, BUT NOT THE DEDUCTION FOR TUITION, WILL ALSO BE
AVAILABLE FOR TRANSPORTATION FOR COLLEGE STUDENTS.

HOME-LEAVE TRAVEL: A DEDUCTION WILL BE ALLOWED FOR
ONE ECONOMY ROUND TRIP FARE EVERY OTHER YEAR FOR EACH
MEMBER OF THE TAXPAYER'S FAMILY BETWEEN A FOREIGN POST AND
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THE TAXPAYER'S RESIDENCE IN THE UNITED STATES. IF THE TAXPAYER MAINTAINS NO RESIDENCE IN THE UNITED STATES, THE DEDUCTION WILL BE ALLOWED FOR TRANSPORTATION BETWEEN THE FOREIGN POST AND THE TAXPAYER'S PLACE OF RESIDENCE BEFORE HE WENT ABROAD.

REPORTS TO TREASURY AND CONGRESS

UNDER THE ADMINISTRATION'S PROPOSAL, GOVERNMENT AGENCIES FURNISHING ALLOWANCES EXCLUDABLE BY THEIR EMPLOYEES UNDER SECTION 912 WILL BE REQUIRED TO SUBMIT ANNUAL REPORTS TO THE TREASURY DEPARTMENT ITEMIZING THOSE ALLOWANCES. THE TREASURY DEPARTMENT WILL ALSO BE REQUIRED TO PRESENT TO CONGRESS EVERY TWO YEARS A DETAILED DESCRIPTION OF THE REVENUE COSTS AND ECONOMIC EFFECTS OF THE EXCLUSIONS UNDER SECTION 912 AND THE DEDUCTIONS UNDER THE NEW SECTION 221.

CHANGES TO SECTION 119 (EMPLOYER-FURNISHED MEALS OR LODGING)

THE ADMINISTRATION'S PROPOSAL WILL BROADEN THE CONDITIONS UNDER WHICH HOUSING AND MEALS FURNISHED BY THE EMPLOYER OVERSEAS CAN BE EXCLUDED FROM INCOME UNDER SECTION 119. HOUSING AND MEALS WHICH ARE FURNISHED IN A CAMP OR BARRACKS OR SIMILAR COMPOUND WILL BE EXCLUDABLE FROM INCOME IF THEY ARE FURNISHED IN THE GENERAL VICINITY OF THE BUSINESS PREMISES OF THE EMPLOYER OR THE PLACE WHERE THE EMPLOYEE'S SERVICES ARE RENDERED AND ARE FURNISHED BECAUSE ADEQUATE ADEQUATE ALTERNATIVE MEALS AND LODGING IN THAT VICINITY ARE NOT AVAILABLE.

CHANGES TO SECTION 217 (MOVING EXPENSES)

THE ADMINISTRATION'S PROPOSAL WILL ALSO AMEND SECTION 217 OF THE CODE TO INCREASE THE TIME LIMITS FOR A MOVE AND ASSOCIATED TEMPORARY LIVING ARRANGEMENTS FROM 30 DAYS TO

60 DAYS, AND TO RAISE THE CEILING ON TEMPORARY LIVING COSTS FROM $1,500 TO $5,000. THE INCREASED TIME LIMITS AND CEILING ON DEDUCTIONS WILL APPLY ONLY TO MOVES FROM THE UNITED STATES TO A FOREIGN COUNTRY, FROM A FOREIGN COUNTRY TO THE UNITED STATES AND FROM ONE FOREIGN COUNTRY TO ANOTHER. SINCE THE ADMINISTRATION'S PROPOSAL WILL REPLACE THE EXISTING SECTION 911 EXEMPTION WITH THE NEW

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SECTION 221 DEDUCTIONS, NO PART OF THE MOVING EXPENSES
WILL BE DISALLOWED AS ATTRIBUTABLE TO EXEMPT INCOME.

CHANGES TO SECTION 1034 (SALE OR EXCHANGE OF RESIDENCE)

THE ADMINISTRATION'S PROPOSAL WILL ALSO AMEND SECTION
1034 OF THE CODE TO SUSPEND THE RUNNING OF THE 18 OR 24
MONTH PERIOD FOR REINVESTMENT OF THE PROCEEDS REALIZED ON
THE SALE OF A PRINCIPAL RESIDENCE. THE SUSPENSION WILL BE
FOR A MAXIMUM PERIOD OF FOUR YEARS AND WILL APPLY ONLY TO
PERSONS WORKING OVERSEAS WHO QUALIFY FOR THE DEDUCTIONS OF
THE NEW SECTION 221 OR THE EXCLUSION OF SECTION 912. VANCE

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